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Agriculture in the New International Economic Order

by

*Luther Tweeten, Carl Zulauf, and Norman Rask**

Dramatic events in Eastern Europe manifest an ongoing world political-economic realignment of singular importance to American food and agricultural industries. These unfolding changes hold greater long-run significance for U.S. agriculture in the 1990s and beyond than does the new farm bill and are potentially more significant than the GATT negotiations. This essay highlights world reordering and its implications for U.S. agriculture.

A Changing World Order

Since the close of the second world war, the international order has been defined largely in terms of two major military-economic-political blocs - NATO and the OCED in the west and the Warsaw Pact and COMECON countries in the east. Over the past several years, major changes have been occurring in each bloc. These changes in large part represent loss in economic performance as a result of over-extension by each of the major bloc superpowers, the U.S. and the USSR, and a growing recognition by each of economic limits to the exercise of world military domination.

Anderson Professor, Assistant Professor, and Professor respectively, Department of Agricultural Economics and Rural Sociology, The Ohio State University, Columbus.

Three seminal changes characterize the breakdown of the old order and the emergence of a new international political-economic order.

1. Disillusionment with Communism as a viable option for serving the aspirations of society, not only in the COMECON countries but throughout much of the third world as well.
2. Within the Western alliance, the formation of three economic superpowers or blocs bent on international economic competition.
3. A general recognition in both blocs that world power and prestige in a techno-scientific age derive from economic rather than military prowess.

Disillusionment with Communism

Failure of Communism as a viable political-economic alternative is the single most visible evidence of the demise of the old international economic order. In fact, Communism has been failing for a long time. Marxism early on was thought to be monolithic and irreversible. Yugoslavia first and China later dispelled that notion. The depth of disillusionment with Communism and the rapidity with which it is abandoned when military control is relaxed is illustrated by recent events in eastern Europe.

Even if the turn of eastern Europe toward democratic capitalism and away from totalitarian socialism is reversed by tanks as in China, pressures for change will remain to reemerge later as centrally planned economies fall ever farther behind other systems in serving fundamental human yearnings for dignity, a standard of living comparable to that in developed market economies, and freedom of choice. A system with no pot of gold at the end of its rainbow also is a less attractive alternative to democratic-capitalism in the third world.

Three Emerging Economic Superblocs

While the east bloc is breaking up out of economic weakness, three economic superblocs or superpowers have emerged out of the west bloc: (a) Japan, (b) the U.S. (and Canada under the free trade agreement), and (c) the EC-12. A milestone for the latter will be major progress toward elimination of border restrictions among members by the end of 1992. Success of the EC-12 could lead to formation of other economic blocs or an expansion of the three economic superpowers into larger trading blocs by incorporating other countries.

Japan as the smallest economic superpower is especially vulnerable to a European bloc augmented in size, economic power, and protectionism. The seemingly natural free trade area comprised of Japan, China, Taiwan, and Korea and perhaps stretched to southeast Asia is beyond reach because of lingering colonial and World War II legacies. Meanwhile, the search for an enlarged free trade area by the United States and Canada could encompass Mexico, Australia, and New Zealand.

Furthermore, the size of these three economic superpowers will energize other countries to develop their economies and is likely to spark renewed interest in large-scale trading blocs. Mental gymnastics can easily carve the world into innumerable permutations of a new international economic order. Second and third world countries such as Brazil, India, China, and the Soviet Union are notably missing from the above scenarios. Each singly or in cooperation with other countries has the potential to be a major global player in the geopolitical-economic game. Despite some progress, these countries currently seem unwilling to make the institutional reforms required for superpower status in the new international economic order.

The Eastern European economic community is unlikely to survive to constitute a fourth major economic power bloc. Czechoslovakia, Poland, and Hungary will turn to the West -- to democratic socialism if not capitalism and attain associate status with the European Free Trade Association in the Common Market. East Germany could go the same route, but, more likely, will find reunification with West Germany irresistible.

The road to western democratic capitalism in the east bloc will be longer and rougher than many anticipate. Political reform will get ahead of economic reform, threatening the reform process because pent up aspirations for political freedom and economic progress can easily outrun economic reality. Development of entrepreneurial and managerial skills and the work ethic takes time, even if central planning and other impediments to a market are fully removed -- and they will not be. In historic perspective, socialism in the form of central planning and state ownership of the means of production has not been compatible with political democracy.

The road to integration of eastern Europe into the global financial community also will not be smooth. To be sure, gaining most-favored-nation status and membership in the GATT, IMF, and World Bank need be no problem. But in several countries unrealistic aspirations will energize the Economic Degradation Process (see Tweeten, *AJAE*, December 1989) characterized by living beyond ones means, inflation, overvalued (nonconvertible) currency, and balance of payments shortfalls. The economic problems of the general economy will be shared by agriculture. Faced with such difficulties, some countries of eastern Europe, while attempting to pursue the Swedish model of the welfare state and capitalistic private industry, are likely to revert to a state of economic stagnation somewhere between democratic capitalism and totalitarian socialism -- which we label the Yugoslavian model.

At any rate, rebuilding of the eastern portion of the "common European home" will consume much of the capital and political energy of western Europe to the year 2000 and perhaps beyond. That gives the U.S. some breathing room but could lead eventually to an even stronger and more competitive European economy.

While renovating southern and eastern Europe will provide a generous Keynesian stimulus helping to maintain full employment in Europe and elsewhere, it will make the goal of a "United States of Europe" without internal borders more elusive. With the fading of the common enemy (USSR), the heterogeneity of the new "western" Europe and the prominence of a united Germany will work against full political and economic union in Europe.

From Military to Economic Confrontation in the 1990s

A likely consideration in the USSR allowing eastern Europe to go its own way is the recognition that a first-class military, with its dependence on high technology and costly weapons, cannot be sustained by a second-class economy. A corollary is the growing recognition that world influence and prestige are based more on economic than on military power. Additionally, much of the general public and many leaders of the major nuclear powers view war among their nations as unthinkable, while at the same time economic turmoil in the Communist countries has lessened the immediate threat of global military conflict. Nevertheless, the French revolution remains a sobering reminder that breakup of the old order even in an atmosphere of good intentions and high ideals can lead unpredictably to violence and chaos.

A current quip is that after over four decades of cold war between the United States and the Soviet Union, the winners have finally emerged: Japan and Germany. By stressing savings, technological excellence, trade, and human resource development rather than military might, Japan and West Germany have become major world players in the economic sphere despite relatively small populations and few natural resources. Meanwhile, global military overreach has contributed to the relative decline of the resource-rich Soviet and American economies.

Japan spends three times as many public dollars on agricultural research per dollar of output as the U.S. In 1988, Japan spent $3.4 billion while the U.S. spent only $2.3 billion on computer chip research and development, despite the importance of the effort to the $300 billion U.S. electronics industry (*Time*, December 4, 1989, p. 68). Despite a population of only one-half the U.S., Japan equals the United States in numbers of scientists and engineers (*The Economist*, December 2, 1989, p. 4 of "Survey"). In short, Japan and Germany build better automobiles and consumer electronics in part because they devote little science, engineering, and industrial resources to the military.

The new order of three or more techno-economic power centers means more entities possessing wherewithal for seminal breakthroughs in cold or hot nuclear fusion, superconductivity, genetic engineering, and a host of other technologies that can raise living standards worldwide. This technological critical mass is likely to increase economic competition among these three economic superpowers and any other economic blocs that emerge.

The U.S. Legacy of the 1980s

While we find it refreshing that perhaps for the first time in history protagonists are not girding for possible military conflict, superpowers bent on competing economically rather than militarily is not all good news for the U.S. Policies of the 1980s have not readied the U.S. to meet world-class economic competition in the new international economic order. To be sure, the U.S. remains the world's premier economic power and possesses a basically sound political-economic system. However, the nation has been weakened by economic policies that will burden the future: a dilapidated infrastructure, financial institution bailout costs, a troubled elementary and secondary public school system, inadequate provision for retirement needs of the baby-boom generation, environmental clean-up and other costs yet to be internalized, huge domestic and foreign debt, and neglect of civilian science and technology.

A large debt incurred to build a productive capital base would not constitute a burden to future generations because a dividend to provide a better quality of life would remain after repaying principal plus interest. For the most part, America's foreign debt of some $600 billion has not financed a productive capital base but instead has been used to finance consumption. Recent studies provide compelling evidence that real net U.S. investment has been hurt rather than helped by foreign debt (see Jon Faust, "U.S. foreign indebtedness: Are we investing what we borrow?" in *Economic Review*, Kansas City Federal Reserve, July/August 1989). Our debtor status has already constrained our options to shape developments in Eastern Europe and elsewhere. Meanwhile, West Germany and Japan have options and the economic power to shape these developments.

Responding to the accumulated IOUs of the U.S. economy will be complicated by several factors including a low savings rate, public distrust of science and technology arising from environmental problems and fear of rapid technological change, further transformation to a slow-growth service economy, and low birth rates. Services, now accounting for three-fourths of the economy, are less cyclical than manufacturing but are also less amendable to productivity advances. Growth in real GNP per capita dropped from an average annual rate of 2.5 percent in the 1960s to 1.7 in the 1970s and 1.8 percent in the 1980s. Responding to IOUs listed earlier suggests even slower growth in the 1990s and beyond.

Implications for U.S. Agriculture

We now turn to implications for American agriculture of the new international economic order. The following predictions assume that the U.S. will conduct agricultural policy to help right its fiscal house and pursues other policies for global competitiveness in the new international economic order:

Eastern Europe Implications

* The role of Eastern Europe in the new international economic order holds the most uncertainty, and thus the implications for U.S. agriculture in this region are also uncertain. Dislocations from restructuring east bloc economies likely will disrupt their food production for the short run, leading to sizable concessional food imports. The U.S. will share with Western Europe in this food aid trade.
* The eventual outcomes of the economic restructuring depend on how much consumption has been subsidized, how much lack of incentives have constrained agricultural production, and to what extent agricultural production has been directed to sub-marginal areas that would not be competitive under free markets. Nevertheless, the mix of farm output and food consumed will shift as market determined prices and incomes become more important in determining what is produced and purchased.
* Currently, excluding Germany and Czechoslovakia, eastern European

countries show lower food consumption levels than counterpart countries in the EC at comparable latitudes, especially for livestock products and vegetable oils. In contrast, they consume more cereals (see table).

* But income levels are not perceived to be sufficient to support even this level of consumption at free market prices. Thus, unless incomes and food aid grow rapidly, consumption levels are likely to decline in the short run.
* In the long run, as incomes rise some expansion in consumption can be expected. The northern tier of eastern European countries show greater levels of livestock product consumption than the southern tier of countries, but lower agricultural self-sufficiency, especially in cereals (see table). Feedgrain and oilseed exports to these countries are possible.
* In the southern tier of eastern European countries, consumptions levels are lower, especially in livestock products (see table 1). Grain production is generally adequate to support larger livestock production. But, in the short run, some livestock product exports may be possible to this region.
* The provision of food supplies to the USSR from COMECON countries is likely to decline, as is already happening in Romania. This, along with the need to meet rising food consumption aspirations in the USSR will lead to continued strong exports from the U.S. to the USSR.
* Significant potential especially in the short and medium term, exists for exports to Eastern Europe and the U.S.S.R. of modern agricultural inputs, such as fertilizer and pesticides, and modern food processing technology. Western Europe will garner most of this trade, but opportunities exist for U.S. businesses.

* In the longer run, restructuring of the eastern bloc away from collective farming, central planning, and general food subsidies and toward economic incentives, access to improved inputs, privatization, and greater efficiency could decrease dependence on food imports. Eastern European countries have considerable natural and human resources to expand food production given needed technological, structural, and incentive changes. The closer the east bloc is incorporated into the European Community, the more generous will be farm production incentives, thus displacing U.S. exports. Better processing technology and improved storage infrastructure should reduce post-harvest waste. In the unlikely case of sharply rising real incomes made possible by economic reform, food demand could outrun domestic supply, generating food imports if farm and food prices are allowed to be at world levels.

Other Implications

* An enlarged European Community to include the east bloc could generate a crisis as production is expanded in response to higher prices. On the one hand, surpluses could lead to additional subsidized exports and trade wars. On the other hand, the higher cost of the CAP in terms of subsidies and indirect costs of higher food prices and hence in wages making nonfarm industrial products less competitive could lead to liberalizing trade and commodity program reform. Similar pressure for international competitiveness in Japan and other high farm support countries could energize international trade and commodity program liberalization. The direction

taken by economic superpowers facing such crossroads will have a major impact on American agriculture.

* While trade skirmishes will be frequent among economic superpowers, diversified wants of affluent nations will not be satisfied from domestic production and will heighten the importance of international trade. Self-sufficiency will not lose its allure but pressures for economic progress and overall competitiveness will constrain interventions protecting domestic agriculture. An economic alliance between any two of the three superpowers could win concessions from the third power.

* A "peace dividend" from reduced military expenditures could be used to reduce the federal deficit and rebuild U.S. infrastructure (including education). U.S. agriculture will benefit from a modest reduction in real interest rates and a better transportation system. The lower interest rates and attendant lower dollar and requirements for servicing international debt can stimulate U.S. farm exports.

* Continuing pressure to meet social and infrastructure needs and maintain fiscal responsibility necessary to compete economically in the new international order will bring careful scrutiny of upper- and middle-class welfare programs. Expensive direct payment programs to farmers will not be sustainable. Food security will remain a concern but policies will attempt to stabilize food supplies at lower real cost than under past commodity programs.

* Mandatory supply control commodity programs insulating U.S. farmers from international markets seem out of the question because of the need for competitiveness and foreign exchange.

* The need for the U.S. farm sector to be economically competitive in the export market will place increased emphasis on reducing production costs. This emphasis will be reinforced by rising domestic real labor and environmental compliance costs. Production will be geared toward maximum economic profits subject to environmental constraints. Production-oriented economic research will be much in demand.
* It will make sense to redirect federal resources from paying farmers not to produce to paying for research, extension, and education required for improved technology and international competitiveness. Additional public resources for science made available from reduced military expenditures and from other sources will be essential for an efficient, sustainable agriculture providing safe and abundant food supplies in the face of world-class competition and environmental constraints.
* The U.S. will be able to substitute economic for some military aid to third world countries as the threat of Marxist revolution diminishes. Our agriculture will benefit to the extent that economic progress expands foreign demand for our grain and meat exports faster than production growth in third-world countries. Further, debt alleviation would expand third-world growth opportunities, increasing incomes and imports of food.

Conclusion

Adaptation of the American economy to the competitive new international economic order will entail sacrifice and opportunities. Some sectors of agriculture protected from economic realities by commodity programs and trade barriers will face difficult adjustments. On the whole, however, a world more driven by economic competition than by military confrontation will be better for American agriculture and for consumers and producers worldwide.

Table 1. Food Consumption Levels And Agricultural Self-Sufficiency Eastern Europe, U.S.S.R., Western Europe, and the U.S. - 1985.

Country or Region	Annual food consumption in tons of cereal equivalents per capita - 1985				Agricultural self-Sufficiency - 1980-85		
	All Food	Cereals	Livestock Products	Veg. Oils	All	Cereals	Livestock
						(percent)	
Eastern Europe	1.78	.18	1.35	.03	92	87	99
Poland	1.73	.20	1.34	.02	95	88	100
Eastern Germany	2.32	.15	1.92	.04	91	80	101
Czechoslovakia	1.98	.15	1.65	.03	98	97	101
Hungary	1.76	.15	1.44	.03	124	112	122
Rumania	1.33	.19	.95	.04	105	100	109
Yugoslavia	1.38	.22	1.01	.04	95	96	101
Bulgaria	1.60	.21	1.19	.05	103	100	111
USSR	1.79	.18	1.34	.04	89	84	96
Western Europe	1.80	.12	1.45	.05	97	103	103
West Germany	2.00	.10	1.69	.04	92	94	102
Austria	1.93	.09	1.63	.06	104	112	106
Italy	1.79	.16	1.44	.07	79	60	80
United States	2.20	.09	1.82	.08	122	157	99

NOTE: Cereal equivalents express all food-related agricultural production and use in terms of primary food calorie value indexed to cereals. For example, livestock products are expressed in terms of grain equivalent of all feeds used in production. Self-sufficiency is determined by dividing domestic food-related agricultural use by domestic food-related agricultural production. Data are adapted from FAO food balance data.